



# FINANCIAL STATEMENTS of the Thrift Savings Fund — 2002 and 2001



## Report of Independent Auditors

To the Executive Director  
Federal Retirement Thrift Investment Board:

We have audited the accompanying statement of net assets available for benefits of the Thrift Savings Fund as of December 31, 2002, and the related statement of changes in net assets available for benefits for the year then ended. These financial statements are the responsibility of the Federal Retirement Thrift Investment Board. Our responsibility is to express an opinion on these financial statements based on our audit. The statement of net assets available for benefits of the Thrift Savings Fund as of December 31, 2001, and the related statement of changes in net assets available for benefits for the year ended December 31, 2001 were audited by other auditors who have ceased operations and whose report dated March 13, 2002, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 2002 financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Thrift Savings Fund at December 31, 2002, and the changes in its net assets available for benefits for the year then ended, in conformity with accounting principles generally accepted in the United States.

McLean, Virginia  
March 19, 2003

*Ernst & Young LLP*

**THRIFT SAVINGS FUND**  
**Statements of Net Assets Available**  
**for Benefits**  
**as of December 31,**

(Dollars in Thousands)

<b>Assets</b>	<b>2002</b>	<b>2001</b>
Investments, at market value:		
U.S. Government Securities Investment Fund	\$46,848,948	\$38,660,018
Barclays U.S. Debt Index Fund	11,047,005	8,217,134
Barclays Equity Index Fund	37,317,190	47,918,227
Barclays Extended Market Index Fund	1,239,019	872,347
Barclays EAFE Index Fund	480,066	300,530
<b>Total investments</b>	<b>96,932,228</b>	<b>95,968,256</b>
Receivables:		
Participants' contributions	381,179	280,526
Employer's contributions	141,867	125,107
Participant loans	4,313,453	3,971,824
Due for securities sold	557,919	225,886
Securities lending income and rebates	190	265
<b>Total receivables</b>	<b>5,394,608</b>	<b>4,603,608</b>
Fixed assets:		
Furniture, equipment, and leasehold improvements, net of accumulated depreciation and amortization of \$5,785 in 2002 and \$5,210 in 2001	469	524
Data processing software, net of accumulated amortization of \$9,856 in 2002 and \$7,020 in 2001	29,327	8,384
<b>Total fixed assets</b>	<b>29,796</b>	<b>8,908</b>
Other assets:	1,919	4,662
<b>Total assets</b>	<b>102,358,551</b>	<b>100,585,434</b>
<b>Liabilities</b>		
Accounts payable	40,454	26,170
Accrued payroll and benefits	1,114	1,064
Deferred rent and lease credits	—	305
<b>Total liabilities</b>	<b>41,568</b>	<b>27,539</b>
<b>Funds restricted for the purchase of fiduciary insurance</b>	<b>(5,354)</b>	<b>(5,095)</b>
<b>Net assets available for benefits</b>	<b>\$102,311,629</b>	<b>\$100,552,800</b>

**THRIFT SAVINGS FUND**  
**Statements of Changes in Net Assets Available**  
**for Benefits**  
**for the Years Ended December 31,**

(Dollars in Thousands)

<b>Additions</b>	<b>2002</b>	<b>2001</b>
Investment income (loss):		
U.S. Government Securities Investment Fund interest income	\$2,086,976	\$1,893,325
Net realized gain (loss) from sale of Barclays funds	(1,807,122)	632,907
Net unrealized appreciation (depreciation) in fair market value of Barclays funds:		
Barclays U.S. Debt Index Fund	864,265	458,423
Barclays Equity Index Fund	(9,013,930)	(7,484,427)
Barclays Extended Market Index Fund	(220,756)	(8,269)
Barclays EAFE Index Fund	(72,519)	(22,599)
Securities lending income and rebates	2,264	1,651
Less investment expenses	(4,270)	(3,903)
<b>Net investment income (loss)</b>	<b>(8,165,092)</b>	<b>(4,532,892)</b>
Contributions:		
Participants'	8,815,515	6,834,002
Employer's	3,496,867	3,170,714
<b>Total contributions</b>	<b>12,312,382</b>	<b>10,004,716</b>
Interest income on participant loans	225,883	219,193
<b>Total additions</b>	<b>4,373,173</b>	<b>5,691,017</b>
<b>Deductions</b>		
Benefits paid to participants	2,422,282	2,593,819
Administrative expenses	70,637	105,666
Participant loans declared taxable distributions	121,166	124,684
<b>Total deductions</b>	<b>2,614,085</b>	<b>2,824,169</b>
<b>Net increases (decreases)</b>	<b>1,759,088</b>	<b>2,866,848</b>
<b>Funds restricted for the purchase of fiduciary insurance</b>	<b>(259)</b>	<b>(88)</b>
	<b>1,758,829</b>	<b>2,866,760</b>
<b>Net assets available for benefits</b>		
<b>Beginning of period</b>	<b>100,552,800</b>	<b>97,686,040</b>
<b>End of period</b>	<b>\$102,311,629</b>	<b>\$100,552,800</b>

See accompanying notes.

# THRIFT SAVINGS FUND

## Notes to Financial Statements

### as of December 31, 2002

#### (1) PLAN DESCRIPTION

The following description is provided for general information purposes. Participants should refer to the *Summary of the Thrift Savings Plan for Federal Employees* or the *Summary of the Thrift Savings Plan for the Uniformed Services* and applicable legislation for more complete information.

The Thrift Savings Plan (the Plan) is a retirement savings and investment plan for Federal employees and members of the uniformed services. It was authorized by the United States Congress in the Federal Employees' Retirement System Act of 1986 (FERSA). The Plan provides Federal employees and members of the uniformed services with a savings and tax benefit similar to what many private corporations offer their employees. The Plan was primarily designed to be a key part of the retirement package (along with a basic annuity benefit and Social Security) for employees who are participants of the Federal Employees' Retirement System (FERS).

The Plan is administered by an independent Government agency, the Federal Retirement Thrift Investment Board (the Board), which is charged with operating the Plan prudently and solely in the interest of the participants and their beneficiaries. Assets of the Plan are maintained in the Thrift Savings Fund (the Fund).

Federal employees who are participants of FERS, the Civil Service Retirement System (CSRS), or equivalent retirement plans, as provided by statute, and members of the uniformed services, are eligible to join the Plan immediately upon being hired. Generally, FERS employees are those employees hired on or after January 1, 1984, while CSRS employees are employees hired before January 1, 1984, who have not elected to convert to FERS. Each group has different rules that govern contribution rates. As of December 31, 2002, there were approximately 3.0 million participants in the Plan, with approximately 2.3 million contributing their own money.

The Plan is a defined contribution plan and, as such, specifies how much an employee may contribute and how much the employing agency must contribute to each FERS employee's account. In 2002, FERS employees could contribute up to 12 percent of their basic pay each pay period, on a tax-deferred basis, and were entitled to receive agency matching contributions on the first 5 percent, according to a formula prescribed by FERSA (5 U.S.C. § 8432(c)). In 2002, CSRS employees and members of the uniformed services could contribute up to 7 percent of their basic pay each pay period, on a tax-deferred basis. The Federal Government does not match any of this amount. For FERS employees, their employing agencies also contribute an agency automatic contribution equal to 1 percent of each employee's basic pay each pay period, as defined in FERSA (5 U.S.C. § 8401(4)). In accordance with the Internal Revenue Code, no participant could contribute more than \$11,000 in 2002. This limit will increase to \$12,000 in 2003.

Pursuant to FERSA (5 U.S.C. § 8438), Plan participants are offered five investment funds: the Government Securities Investment Fund (G Fund), the Fixed Income Investment Fund (F Fund), the Common Stock Index Investment Fund (C Fund), the Small Capitalization Stock Index Investment Fund (S Fund), and the International Stock Index Investment Fund (I Fund). Participants may allocate any portion of their contributions among the five investment funds. Also, participants may reallocate their entire account balance among the five investment funds through the interfund transfer process. Participants can make an interfund transfer as of the end of any month without an annual limit.

Plan participants are immediately vested in all of their own contributions and attributable earnings. Participants are also imme-

diately vested in any agency matching contributions made to their accounts and attributable earnings. In order to be vested in the agency automatic (1%) contributions, a FERS employee must have either 2 or 3 years of service as described in section 8432(g) of FERSA. FERS employees who are not vested and who separate from the Federal Government forfeit all agency automatic contributions and attributable earnings. Forfeited funds, comprising primarily monies forfeited pursuant to 8432(g), totaled \$9,751,000 in 2002 and \$11,151,000 in 2001, and, by law, are used by the Fund to pay accrued administrative expenses. If the forfeited funds are not sufficient to meet all administrative expenses, earnings on investments are then expended.

Participants may apply for loans from their accounts. There are two types of Plan loans: general purpose and residential. General purpose loans can be obtained for any purpose, with a repayment period from 1 to 4 years. Residential loans can be obtained for the purpose of purchasing a primary residence, with a repayment period from 1 to 15 years. Participants may borrow only their own contributions and attributable earnings. The minimum loan amount is \$1,000. The interest rate for loans is the G Fund rate at the time the loan application is received by the Board's record keeper. The rate is fixed at this level for the life of each loan. Participant loans are valued at their unpaid balances, which are fair value.

#### (2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**A. Basis of Accounting.** The activity of the Fund is accounted for using the accrual basis of accounting. Revenue is recognized when earned and expenses are recognized when incurred. Benefits are recorded when paid.

**B. Investments.** As of, and during the period ended, December 31, 2002, investments of each investment fund were in the following:

**The G Fund** was invested in short-term nonmarketable U.S. Treasury securities specially issued to the Fund. All investments in the G Fund earned interest at a rate that is equal, by law, to the average of market rates of return on outstanding U.S. Treasury marketable securities with 4 or more years to maturity.

**The F Fund** was invested primarily in the Barclays U.S. Debt Index Fund "E," which in turn holds shares of the Barclays U.S. Debt Index Master Fund. Both the U.S. Debt Index Fund "E" and the Master Fund are passively managed commingled funds that track the Lehman Brothers U.S. Aggregate Bond Index.

As of December 31, 2002, the Barclays U.S. Debt Index Master Fund contained approximately 37 percent mortgage-backed securities, 24 percent investment-grade corporate securities (U.S. and non-U.S.), 22 percent U.S. Treasury securities, 13 percent Federal agency securities, and 4 percent foreign government securities (dollar-denominated securities traded in the U.S. that are issued by foreign or international entities (sovereigns, multilateral lending institutions, foreign agencies, and foreign local governments)). The mortgage-backed sector contains securities guaranteed by the Government National Mortgage Association, Fannie Mae, and Freddie Mac, as well as commercial mortgaged-backed securities. The Board invests in (or redeems from) the Barclays U.S. Debt Index Fund "E" on a daily basis. As of December 31, 2002, the Barclays U.S. Debt Index Master Fund held 3,300 securities totaling \$19.9 billion, with a weighted average life of 5.7 years. The U.S. Debt Index Fund "E" held shares of the Master Fund totaling \$12.1 billion, and the F Fund holdings constituted \$11.0 billion of the December 31, 2002, value of the "E" Fund.

**The C Fund** was invested primarily in the Barclays Equity Index Fund “E,” which in turn holds shares of the Barclays Equity Index Master Fund, plus a liquidity reserve that is invested in futures contracts. Both the Equity Index Fund “E” and the Master Fund are passively managed commingled funds that track the S&P 500 index. The Equity Index Master Fund holds stocks of all the companies represented in the S&P 500 index in virtually the same weights as they are represented in the S&P 500 index. The Board invests in (or redeems from) the Barclays Equity Index Fund “E” on a daily basis. As of December 31, 2002, the Barclays Equity Index Master Fund held \$92.7 billion of securities. The Barclays Equity Index Fund “E” held shares of the Master Fund totaling \$39.0 billion, and the C Fund holdings constituted \$37.3 billion of the December 31, 2002, value of the “E” Fund.

**The S Fund** was invested primarily in the Barclays Extended Market Index Fund “E”, which in turn holds shares of the Barclays Extended Market Master Fund, plus a liquidity reserve that is invested in futures contracts. Both the Barclays Extended Market Index Fund “E” and the Master Fund are passively managed commingled funds that track the Wilshire 4500 index by holding most of the stocks with larger capitalizations in virtually the same weights as they are represented in the index, and by holding a representative sample of the remaining stocks in the index. The Board invests in (or redeems from) the Barclays Extended Market Index Fund “E” on a daily basis. As of December 31, 2002, the Barclays Extended Market Index Master Fund held \$10.7 billion of securities. The Barclays Extended Market Index Fund “E” held shares of the Master Fund totaling \$2.2 billion, and the S Fund holdings constituted \$1.2 billion of the December 31, 2002, value of the “E” Fund.

**The I Fund** was invested primarily in the Barclays EAFE (Europe, Australasia, Far East) Index Fund “E,” which in turn holds shares of the Barclays EAFE Index Master Fund, plus a liquidity reserve that is invested in futures contracts. Both the Barclays EAFE Index Fund “E” and the Master Fund are passively managed commingled funds that track the Morgan Stanley Capital International EAFE Index. The Barclays EAFE Index Master Fund holds stocks of all the companies represented in the EAFE index in virtually the same weights as they are represented in the index. The Board invests in (or redeems from) the Barclays EAFE Index Fund “E” on a daily basis. As of December 31, 2002, the Barclays EAFE Index Master Fund held \$21.5 billion of securities. The Barclays EAFE Index Fund “E” held shares of the Master Fund totaling \$583.0 million, and the I Fund holdings constituted \$480.1 million of the December 31, 2002, value of the “E” Fund.

**The F Fund, C Fund, S Fund, and I Fund** included temporary investments in the same securities held by the G Fund pending purchase of shares in their respective index funds and to cover liquidity needs, such as loans and withdrawals from the Plan.

All investments are stated at fair market value, as established by quoted prices at year-end.

**C. Fixed Assets.** All fixed assets were recorded at historical cost. Assets with a useful life in excess of 1 year and a cost greater than \$25,000 were capitalized and expensed over their useful life using the straight line method. The estimated useful lives are as follows:

Furniture and Equipment	3 to 10 years
Leasehold Improvements	10 years
Data Processing Software	3 years

**D. Earnings Allocation.** Net earnings were allocated to the participants’ accounts monthly. The allocation process used was that described in regulations issued by the Executive Director on November 20, 1996.

**E. Contributions Receivable.** Contributions receivable were estimated as the amount of contributions recorded through the first 2 weeks of the month following the date of the financial statements.

**F. Loans Payable to Participants.** Loans payable to participants are a component of net assets available for benefits. In January 2003, approximately \$177,842,000 will be disbursed from accounts of those who were participants of the Plan as of December 31, 2002.

**G. Withdrawals Payable.** Withdrawals payable are a component of net assets available for benefits. In January 2003, approximately \$164,045,000 will be disbursed from accounts of those who were participants of the Plan as of December 31, 2002.

**H. Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### (3) INCOME TAX STATUS

FERSA (5 U.S.C. § 8440(a)(1)) states that the Plan shall be treated as a trust as described in section 401(a) of the Internal Revenue Code (Code) which is exempt from taxation under section 501(a) of the Code. This status was reaffirmed in the Tax Reform Act of 1986, Section 1147 (codified at I.R.C. § 7701(j)). It is not necessary for the Plan to apply for a determination letter since it is qualified by statute.

### (4) COMMITMENTS AND CONTINGENCIES

The Board has entered into Interagency Agreements with the Department of Agriculture’s National Finance Center (NFC). Under the agreements, the NFC performs detailed record keeping of participant account balances (operations) and software development, and maintains a service office responsible for loan, withdrawal, and interfund transfer processing, as well as servicing employees who have left Federal service. These agreements may be canceled by the Board with 3 months’ notice or by the Department of Agriculture with 1 year’s notice. The NFC’s fees for fiscal year 2003 are estimated to be \$54,496,000.

On May 20, 1997, the Board entered into a contract with American Management Systems, Inc. (AMS) for the design, development, and implementation of an automated daily valued record keeping system based on a commercial product created by SunGard Employee Benefit Systems. Work commenced in 1997.

On July 17, 2001, the Board terminated its contract with AMS for default. Concurrent with termination of the contract, the Board’s Executive Director filed suit on behalf of the Fund against AMS in the United States District Court for the District of Columbia. The lawsuit alleges that AMS breached its contract to construct the Board’s computerized record keeping system and committed fraud in connection with the contract. The lawsuit seeks to recover actual damages of approximately \$50 million and punitive damages of \$300 million. On November 30, 2001, the court entered an order granting AMS’s motion to dismiss for lack of subject matter jurisdiction. On December 5, 2001, the Board filed a notice of appeal of the decision; the appeal was argued on March 7, 2003, before the United States Court of Appeals for the District of Columbia Circuit. If the Board does not prevail on this or any further appeals, it is possible for the suit to be refiled by the Department of Justice on behalf of the Fund.

On October 10, 2001, AMS filed a complaint against the United States of America in the United States Court of Federal Claims. This suit alleges that the Board improperly terminated AMS for default. AMS seeks a judgment that the Board breached its contract with AMS and that the termination for default should be treated as a termination for the convenience of the Government. AMS’s complaint does not seek monetary damages. On August 30, 2002, the judge denied the United State’s motion to dismiss the complaint on the ground that the court lacked jurisdiction to hear the action. Although the court agreed to certify the decision for an interlocutory



appeal, the Court of Appeals for the Federal Circuit declined to hear an immediate appeal of the jurisdiction issue. The Department of Justice has filed a second jurisdictional motion in an effort to have the case dismissed without a trial on the merits.

As a contingency against the potential performance failure of AMS, in January 2001, the Board awarded a contract to Materials, Communication & Computers, Inc. (MATCOM). On August 1, 2001, the Board authorized MATCOM to begin work on the same project that AMS had been unable to complete. Under the terms of the Board's contract with MATCOM, the project is expected to cost approximately \$26.1 million. The new system is expected to be completed in 2003.

Total costs incurred under the AMS contract of \$53 million, together with internal systems development costs of \$12 million, were capitalized as data processing software through 2001. The Board, with the assistance of MATCOM, determined that only \$1 million of the capitalized costs were salvageable, and that the other \$64 million of capitalized costs had no ongoing value. Therefore, \$23 million of capitalized data processing software and its associated accounts payable, which were derived from unpaid AMS invoices, were reversed from the 2001 statement of net assets available for benefits. The remaining \$41 million of capitalized data processing software was written off from the 2001 statement of net assets available for benefits and reflected as administrative expenses in the 2001 statement of changes in net assets available for benefits. The \$41 million has not been charged to participant accounts. To the extent that amounts are recovered from AMS, those proceeds will be applied against the \$41 million, and any remaining gain or loss will be amortized to the participants' accounts. If the Board determines that there will be no recovery from AMS, it will amortize the \$41 million to participants' accounts.

The Board leases the office space it occupies in Washington, D.C., under an operating lease. The operating lease ends in 2012, with an option to extend for two 5-year periods. Monthly base rental payments under the lease range from approximately \$106,000 to \$127,000. Accounting principles generally accepted in the United States require that rent expense be recognized equally over the term of the lease. This results in more rent expense than rent paid in the early years of the lease. The difference between rent expense and rent paid is reflected as deferred rent in the statement of net assets available for benefits. Monthly base rent expense over the term of the lease is \$116,000.

## **(5) FIDUCIARY INSURANCE**

FERSA (5 U.S.C. § 8479(b)(1)) provides that the Executive Director may assess Federal agencies for the purpose of buying fiduciary insurance. The Executive Director exercised this authority in 1987 and required agencies to submit an amount equal to 1 percent of their agency automatic contributions. Such sums were collected during 1987 and 1988 and are invested to the extent not currently required to purchase fiduciary insurance. In February 1988, the Executive Director instructed agencies to discontinue the 1 percent fiduciary insurance contributions. The balance of funds available for the purchase of fiduciary insurance as of December 31, 2002, was \$5,354,000, which has been invested in the same securities held by the G Fund and included in total investments on the accompanying statement of net assets available for benefits. The Board has determined that the current insurance reserve is adequate to fund coverage needs for the foreseeable future.